No. 06-484

IN THE

Supreme Court of the United States

TELLABS, INCORPORATED AND RICHARD NOTEBAERT,

Petitioners,

v.

MAKOR ISSUES & RIGHTS, LTD., ET AL.,

Respondents.

ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

BRIEF FOR AMICI CURIAE ALLAN N. LITTMAN AND WILLIAM I. EDLUND IN SUPPORT OF THE POSITION OF RESPONDENTS

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INTEREST OF AMICI CURIAE[1]

Amici Curiae are members of the Bar of the State of California and of this Court. Each has been practicing law for over fifty years. They have defended and brought claims against corporate officers, investment bankers and accountants in securities and fraud actions, and represented Federal and State agencies in auditing matters. They are familiar with the duties and legal responsibilities of auditors and chief executives and the involvement in the formulation of those duties by the Securities and Exchange Commission ("SEC") and the American Institute of Certified Public Accountants ("AICPA"). Amici Curiae request leave to file this brief because (1) they believe the court will be assisted by their experienced, informed and independent views, and (2) private securities class actions are an essential supplement to SEC actions in enforcing the antifraud provisions of the Securities Acts. They provide some measure of protection to the nearly one hundred million Americans who directly or indirectly own shares of stock. Amicus Curiae have read and are familiar with the briefs filed by the parties and other amicus curiae and do not believe the views expressed in this brief have been presented to the Court so far.

Amici urge the Court to affirm the judgment below. The Court should reject Petitioners' attempt to carve out an exception to the established rules on burden of proof and standards for motions to dismiss in order to provide a near automatic pleading escape route to corporate executives, directors and auditors sued for fraud.

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[1] The parties in this case have advised the Clerk of the Court by letters dated February 5 and February 6, 2007 that each party consents to the filing of all Amici Curiae briefs. None of the counsel for the parties or the parties authored this brief in whole or in part. The brief was wholly authored by Amici, and no person or entity other than Amici have made a monetary contribution to the preparation or submission of this brief.

SUMMARY OF ARGUMENT

The Public Company Securities Class Action Reform Act of 1995 ("PSLRA") was not designed to cripple nonabusive private securities actions for fraud. It did not change the established preponderance of evidence standard by which a trial judge determines at the pleading, summary judgment and trial stages if a plaintiff has presented a genuine issue of fact for trial by jury. The PSLRA requirement is that a plaintiff shall "with respect to each alleged specified fraudulent and material act or omission alleged to violate this Chapter, state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." This requirement does not permit the dismissal of a complaint which alleges such facts with particularity on the basis that it also hypothetically raises facts indicating a "substantial possibility" or "equal likelihood" of the contrary.

The court of appeals correctly determined (1) the complaint here alleged with particularity facts on which plaintiffs' belief had been formed that material fraudulent representations had been made and gave rise to a strong inference of Tellabs' chief executive officer's scienter, and (2) a reasonable jury could determine that each of the alleged fraudulent material representations was made with scienter. Contrary inferences hypothesized by Petitioner and their amici do not extinguish those strong inferences, and certainly do not neuter them to preclude, as a matter of law, a reasonable jury accepting them as establishing the requisite scienter.

ARGUMENT

I. THE PSLRA DID NOT CHANGE ESTABLISHED JUDICIAL PROCEDURES ABOUT THE BURDEN OF PROOF.

In response to huge financial frauds involving chief executives, auditors and financial services firms, Congress passed the Sarbanes Oxley Act ("SOX") (116 Stat. 745) by a vote of 99-0 in the Senate and 423-3 in the House of Representatives. When President Bush signed the Bill into law on June 30, 2002 he announced that "The era of low standards and false profits is over." In order to deter and prevent fraud and assist shareholders against its effects, SOX added numerous features to the Securities Acts to increase the duties owed by auditors, executives and directors. It also created the Public Company Accounting Oversight Board, whose powers include the establishment or adoption of auditing standards. (15 U.S.C. §§ 72117219, 72317234, and 72417246.) It did not indicate any intent to lessen the rights of shareholders and other private parties to bring actions in federal court against those who defrauded them, or to change the Federal Rules of Civil Procedure or the courts' general application of the plaintiff's burden of proof.

This case concerns the requirements of the PSLRA to prevent abusive lawsuits with sham claims of fraud. (15 U.S.C. § 78u4(b)(1) and (2).) The Act was not intended to create, as the proceedings in this case have, a five year obstacle course for plaintiffs that present a prima facie case of fraud. Subsection (1) requires that the complaint specify the misleading statements and their materiality, and if it is filed on information and belief "state with particularity all facts on which that belief is formed." Subsection (2) provides that:

> "In any private action arising under this chapter in which the plaintiff may recover money damages

> only on proof that the defendant acted with a particular state of mind, the complaint shall, with respect to each alleged specified fraudulent and material act or omission alleged to violate this chapter, state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind."

Subsection (2) refers to "proof" but does *not* purport to alter the burden of proof in any way. The burden of plaintiffs on defendant's motion to dismiss a private securities class action cannot exceed the burden a plaintiff has on a motion by a defendant for summary judgment, or at trial. Those rules were clear before the PSLRA. The Court held in *Herman & MacLean v. Huddleston*, 459 U.S. 375 (1983), that the existence of the implied right of action under section 10 b and Rule 10 b-5, "is simply beyond peradventure," (*id.* at 380), and confirmed that the burden of proof at *trial* in a private securities class action under § 10 b of the 1934 Act was "by a preponderance of the evidence" and not by "clear and convincing evidence." (*id.* at 388-390.) The interests of plaintiffs in securities lawsuits are "significant" because "[d]efrauded investors are among the very individuals Congress sought to protect in the securities laws." (*id.* at 390.) Congress did not purport to change that burden in the PSLRA.

In *Matsushita Elec. Ind. Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986) this Court held that a plaintiff need only establish a "genuine issue of material fact" to resist a motion for summary judgment. Although the Court concluded that the claim was economically implausible under antitrust concepts, it held, that even then, evidence could still be admitted though it "must 'tend to exclude the possibility' that petitioners underpriced respondents to compete for business rather than to implement an economically senseless

conspiracy." There is nothing "economically senseless" about executives falsely representing sales to be "strong" when they are weak, or in shipping product that was not ordered. They are typical signposts of fraud by CEOs. Directly applicable is the 1987 Report of the "National Commission on Fraudulent Financial Reporting," known as the Treadway Commission, after its Chairman James C. Treadway, a former SEC Commissioner.[2] It emphasizes, like the present case, that

> "In a large majority of cases ... the company's top management, such as the CEO, the President, and the CFO were the perpetrators ... [w]hile the perpetrators of fraudulent financial reporting use many different means, the effect of their actions is almost always to inflate or 'smooth' earnings or overstate the company's assets ... [it] usually does not begin with an overt intentional act ... In many cases ... [it] ... is the culmination of a series of acts designed to respond to operational difficulties" (*id.* at 24)

"As the pressure mounts, he [the CEO] compounds the situation by delaying the recognition of sales returns, instructing sales representatives to make the sales 'stick'." Finally, "he commits a fraudulent act by recognizing revenue from inventory shipped to a customer without authorization or from inventory shipped to a public warehouse." (*id.* at 24-25) That description virtually mirrors Notebaert's conduct.

In *Eastman Kodak Co. v. Technical Service Inc.*, 504 U.S. 451, 471-474 (1992), the Court held that "Matsushita

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[2] The Commission was appointed by the American Institute of Certified Public Accountants, the American Accounting Association, the Financial Executives Institution, the Institute of Internal Auditors and the National Association of Accountants. The Treadway Commission Report is available from the AICPA at www.cpa2.biz.com.

demands only that the nonmoving party's inference be reasonable in order to reach the jury .. ." (*id.* at 468); and that, in the case before it, *Kodak* failed to demonstrate that respondent's inference of market power was unreasonable. (*Id.* at 477.) "One Lesson of *Kodak*, which perhaps should have been apparent all along, is that summary judgment based on implausibility of the opponent's claim will rarely succeed." Schwarzer and Hirsch, SUMMARY JUDGMENT AFTER EASTMAN KODAK, 45 Hast.L.J. 1, 67, 10 (1993).

In *Anderson v. Liberty Lobby*, 477 U.S. 242 (1986), this Court explained the burden on a movant for summary judgment as follows: A "summary judgment will not lie if the dispute about a material fact is 'genuine' that is, if the evidence is such that a reasonable jury could return a verdict for the nonmoving party" (*id.* at 249). At the summary judgment stage, the judge's function is not "to weigh the evidence and determine the truth of the matter but to determine whether there is a genuine issue of fact" (*id.* at 249). The standard for a grant of summary judgment is the same as the standard for a directed verdict: "If reasonable minds could differ as to the import of the evidence, however, a directed verdict should not be directed," (*id.* at 249-250). A "summary judgment should be refused if the nonmoving party has not had the opportunity to discover information essential to his opposition to the motion" and FRCP 56(f) requires that he be given the opportunity to discover it (*id.* fn. 5 at 251).

In *Celotex Corp. v. Cartrett* 477 U.S. 317 (1986), this Court held that a moving party could prevail on summary judgment by pointing to the absence of any factual support for an essential element of the claim. On remand, the court of appeal held that a single letter supplied sufficient evidence of that essential element (knowledge of the deceased employee's exposure to Firebox fireproofing) and that

summary judgment should be denied. *Cartrett v. Johns Manville Sales Corp.*, 826 F.2d 33, 37-38 (D.C. Cir. 1987).

Nonabusive private securities class actions are a major deterrent to fraud. They are generally the only practical means of even partial compensation for the victims of fraud. Less than five years after the "era of low standards and false profits" was declared to be "over," Petitioner, the SEC, AICPA and other amici curiae are here attempting a virtual abolition of such actions. They would convert the PSLRA into a barrier against nonabusive lawsuits by allowing defendant executives, auditors and others to use an "any excuse will do" argument as a basis to dismiss claims which state, as this complaint does, particulars of fraudulent and material misrepresentations and strong inferences of fraud from which a reasonable jury could determine the scienter (intent or recklessness) required for fraud.

The SEC, an agency charged with the responsibility of protecting investors, proposes a position which would preclude many meritorious shareholder actions against those who have defrauded them. The SEC urges:

> "When the facts alleged in the complaint give rise to a substantial possibility that the defendant acted without scienter, the necessary 'strong inference of scienter will be lacking, because there will be an insufficient likelihood that the conclusion that the defendant acted with scienter follows from the facts alleged in the complaint as a whole.' Amicus Curiae Brief for the United States, p. 25."

Petitioners ostensibly propose a lesser standard, which would require dismissal if a defendant could argue that the facts suggest a possibility equal to that urged by plaintiffs. Its proposed application of that standard, however, shows

that it is close to that of the SEC. There is no basis in the text of PSLRA, its legislative history, precedent or common sense for either proposed interpretation. On a motion to dismiss, a plaintiff is entitled to the application of the same standard that applies on a motion for summary judgment and on a motion for a directed verdict. The action may not be dismissed if "a reasonable jury could return a verdict for the nonmoving party." *Anderson, supra,* 477 U.S. at 249. That was precisely the standard applied by the court of appeals.

Congress manifested no intent to impose upon a plaintiff at the pleading stage a greater burden of persuasion than that plaintiff would be required to show in responding to a motion for summary judgment or a motion for directed verdict. The burden proposed by the SEC provides a defendant accused of fraud in a private securities class action with an easier defense at the pleading stage than that of a criminal defendant, who can gain an acquittal only if there is a reasonable doubt of guilt, and at the pleading stage only if there is no plausible reason for the charge.

Subsection (b)(2) of 15 U.S.C. § 78u4 did not purport to alter in any way a plaintiff's burden of proof at any stage: pleadings, summary judgment or trial. A defendant can only avoid having the trier of fact decide the factual issues in a case if a reasonable jury could not find for the plaintiff. The very notion of a judge measuring factual issues in advance of discovery or trial with such precision as to state their equality is illusory, and would force district judges into subjective analysis of the comparative weight of inferences that were not weak. The balance is not mathematical: it is a determination that each side's contention is one which a reasonable jury might make. Even when each side's contentions, or inferences, are equal, that determination must be left to the jury or, if waived, a judge, after trial.

II. PETITIONERS AND THEIR AMICI ARE WRONG IN URGING THAT PLAINTIFFS' COMPLAINT HERE SHOULD BE DISMISSED ON THE HYPOTHESIS THAT PLAINTIFFS FAILED TO CARRY A HIGHER BURDEN THAN IS REQUIRED AT SUMMARY JUDGMENT OR TRIAL.

Petitioners' contentions or inferences are, in fact, far short of any equality with those alleged by plaintiffs. With respect to falsity and materiality, both the district court and the court of appeals held that the complaint pleaded with sufficient particularity that the CEO of Tellabs, "made false and misleading statements in regard to three of the four items of fraud: the TITAN 5500, the TITAN 6500, and the company's past results." (Opinion (hereafter "Op.") p. 22.) The court of appeals determined that the allegations concerning projected revenues also sufficiently alleged false and misleading statements.

As the court of appeals noted, plaintiffs' complaint, based on information from 27 confidential sources, alleged that Tellabs was flooding customers with unordered TITAN 5500 products (Op. p. 14). In late 2000, Verizon, its largest customer cut its orders by 25%. (Op. p. 11). On December 11, 2000, Notebaert, Tellabs' CEO, represented that demand for TITAN 5500 product "is still growing strong," and a Tellabs' Press Release stated that the TITAN 6500 product was available now (Op. p. 13). On January 23, 2001, a Tellabs' Press Release announced record sales in the 4th quarter of 2000, and in January 2000, Verizon cut its orders for the 5500 down to 50%. (Op. pp. 11-12) Tellabs obtained extra warehouse facilities to house returned product (Op. p. 14). On February 14, 2001, CEO Notebaert represented in Tellabs' annual report for 2000, in response to "a frequently asked question whether demand for the

TITAN 5500 product had peaked," that "No, although we introduced the product nearly 10 years ago, it's still going strong." (Op. p. 12) In that same month one of the 27 confidential sources stated that Verizon's chairman told Tellabs to stop providing Verizon, Tellabs' largest customer, with products that Verizon did not request or require. (Op. p. 14)

A Deutsche Bank analyst asked Tellabs' executives on March 8, 2001 "whether Tellabs was experiencing any material weakness." Notebaert replied "We're still seeing that product continues to maintain its growth rate; it's still experiencing strong acceptance." (Op. p. 12) On June 19, 2001 Tellabs reduced projections for the 2nd quarter, which had been projected at $720-$820m, to $500 million. In a conference call on that date, Notebaert informed investors that the reduction was almost entirely because of an enormous reduction in TITAN 5500 sales. (Op. pp. 4-5)

On those facts, the court of appeals held that a strong inference of scienter had been pleaded with respect to each of the four materially false representations as follows:

TITAN 5500: product: Plaintiffs had shown enough for a reasonable person to infer that Notebaert knew that his statements were false. According to another confidential source, "Notebaert stayed on top of the company's financial health through weekly conversations with his fellow executives. Given the significance of the TITAN 5500 and the number of reports suggesting that his statements were false." (Op. pp. 23-24)

TITAN 6500: A former Tellabs sales director said that Notebaert saw weekly sales reports and projection reports, and a former highlevel sales executive reported that Notebaert knew it was not ready for deployment. "We conclude that

the plaintiffs have pleaded sufficient facts to give rise to a strong inference that Notebaert knowingly lied when he informed investors that the 6500 was 'available now'." (Op. p. 25)

2000 Revenue: The plaintiffs alleged facts sufficient to show that Notebaert knew of the channel stuffing. "Indeed, a former senior business manager at Tellabs informed the plaintiffs that Notebaert 'worked directly with Tellabs'[s] sales personnel to effect the channel stuffing" and a highlevel sales executive claimed that Notebaert unquestionably knew of it. (Op . 26)

Projections: "The scienter for the misrepresentations serves as sufficient circumstantial evidence." (Op. p. 26)

Of the four general indications of scienter referred to in *Novak v. Kasaks*, 216 F.3d 300, 311 (2d Cir. 2000) the second, (engaging in deliberately illegal behavior), third (knowledge of facts of access to information suggesting that the public statements were not accurate), and fourth (failure to check information they had the ability to monitor) are applicable. As the court held in *Pirraglia v. Novell, Inc.*, 339 F.3d 1182, 1187, 1188 (10th Cir. 2003):

> "We emphasize that this process does not involve a 'weighing' of the plaintiff's suggested inference against other inferences. Faced with two seemingly equally strong inferences, one favoring the plaintiff and one favoring the defendant, it is inappropriate for us to make a determination as to which inference will ultimately prevail lest we invade the traditional role of the factfinder."

Ironically, CEO Notebaert's false statements that TITAN 5500 sales were "strong" rather than "weak," illustrates the

real meaning of the statutory phrase. A particular inference is strong if a reasonable jury could find in favor of it; if not, the inference is weak. TITAN 5500 sales were in fact weak. If the CEO did check, he knew his statement was false, and if he did not check before making the statement, he is charged with knowledge that they were weak. In either case, he had the requisite scienter.

Overall, it is a caricature of realty for Petitioners to argue for dismissal of this complaint on the ground that the CEO of Tellabs did not know what he was talking about when he made his false representations. Their contentions, and those of the SEC and other amici, that his claimed lack of knowledge should be given greater credence than the contrary allegations of the complaint supported by 27 confidential informants has no place in the consideration of a motion to dismiss. A personal profit motive is not necessary for scienter. (Op. p. 20) Petitioners know the dates on which Tellabs ordered and received the designated "early 2001" $100,000 Probe Report and manager's reports. If they thought those dates conclusively rebutted any genuine issue concerning their particular relevance to the intent of the CEO, they could have presented those details, and particular discovery about them could have been permitted under 15 U.S.C. § 78u4(3)(B) "to prevent undue prejudice."

Petitioners' speculation that channel stuffing might have been partially due to discounts would not, even if true, detract from the facts that (1) the discounts reflected a weak demand, (2) its largest customer Verizon cut orders by 50%, telling Tellabs it had sent shipments that had not been ordered, and (3) warehouses had to be leased to receive extraordinarily greater quantities of returned products. Petitioners' contentions concerning Tellabs' revising its projections downward from March 7 onward, fail to note that the March and April reductions were trivial in view of the collapse of

the TITAN 5500 market and the unreadiness of the TITAN 6500 market.

The recurring problem of who will guard the guardians requires a brief response to AICPA's brief which is joined by major audit firms who audit over 90% of the financial statements of entities on national exchanges. AICPA is not a reliable source for an objective discussion of the problem of enforcing the duties of auditors to detect and disclose fraud. It has a long history of attempting to evade auditor's duties to detect and disclose fraud, and opposing legal responsibility for failure to perform those duties, notwithstanding the vital importance of those duties to the investing public and the integrity of financial markets. The SEC, In The Matter of McKesson & Robbins, Accounting Series Release No. 19 (1940) left, "until experience should prove to the contrary," the promulgation by AICPA of an auditing standard stating the auditor's duties to detect and disclose fraud. (*Id.* at 11.) AICPA had still failed to promulgate a fraud standard when the court of appeals decided the landmark case of *United States v. Simon*, 425 F.2d. 796 (2d. Cir. 1969) *certiorari denied* 397 U.S. 1006 (1970).

The defendant auditors in *Simon* were prosecuted for conspiracy to willfully falsify or cover up a material fact under 18 U.S.C. § 1001 and 15 U.S.C. § 78ff. The auditors had given a "clean opinion" concerning the financial statements of a corporation they knew to be insolvent. They did so by including as an asset the face value of a promissory note from its President, which they knew he could not pay, and which was mostly secured by his stock in the insolvent corporation. A footnote to the financial statements stated that the note was secured with "marketable securities." The defense, supported by eight expert witnesses who were "leaders of the profession," was that accounting principles

did not require the identification of the securities. (*Id.* at 805.) In affirming their conviction, the court of appeals held that "once fraud had been discovered full disclosure must be the rule." (*Id.* at 807.)

Under the rule proposed by the SEC and AICPA, a defendant could successfully urge dismissal with prejudice of a complaint in a private securities action alleging analogous facts, on the theory that there was a substantial possibility that the required state of mind could not be inferred because an accountant relied on such an accounting principle. Indeed, the executive and the accountant would argue that they conferred together and agreed there was a "substantial possibility" that it would not be fraud. That is not speculation. Professor Donald J. Kirk emphasized the point in explaining why it will be difficult for the accountants to regain trust (Journal of Accountancy On Line Issues, 2005, REGAINING TRUST, SEVEN VOICES FROM THE PROFESSION (http://aicpa.org/pubs/jofa/oct2005/ voices.htm)). In his 45 years of association with the accounting profession:

> "[W]hat disappointed me most were professionals convincing themselves that doing anything other than what was specifically prohibited was fair game .... Cap all that with the years of effort to minimize the professions responsibility for the detection of fraud, and you have some of the reasons why regaining trust will take a gigantic effort ..."[3]

In 1974, in the wake of the Equity Funding and other enormous national financial scandals, AICPA appointed the Commission on Auditor's Responsibilities, known after its

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[3] Donald J. Kirk is a former chairman of the Financial Accounting Standards Board, a recipient of the AICPA's gold medal for distinguished service, and a former partner of Price Waterhouse.

Chairman, Manuel Cohen, formerly Chairman of the SEC. The Cohen Commission's Report, in 1978, related the erosion by AICPA and others of "The straightforward recognition of the detection of fraud as an object of an audit" and the seeming disavowal by the accounting profession of "all but an incidental concern for fraud detection." (AICPA, THE COMMISSION ON AUDITORS' RESPONSIBILITIES: REPORT, CONCLUSIONS, AND RECOMMENDATIONS (New York: AICPA, 1978), 33, 35 (available at the University of Mississippi Library, only to AICPA members.) The result was, as the Treadway Commission reported in 1987, that "a survey of accounting and auditing textbooks indicate[d] that the coverage of fraudulent financial reporting is minimal to nonexistent." (Treadway Commission Report, *supra*, at 108)

It was not until 1989, nearly fifty years after the SEC called on AICPA to promulgate an effective standard of an auditor's duty to detect fraud that it adopted SAS 53. The word "fraud" did not even appear in the title of an auditing standard until SAS 82 (which only became effective in 1998). The current standard, SAS 99, adopted in 2002 is still defective in many respects. As for current performance of those duties, on January 22, 2007, a PCAOB Report, Release No. 2007-001, identified the following continuing deficiencies in the performance of audits by audit firms: *knowledge* of fraud and fraud risks; *adequate responses* to identified fraud risk factors; *expansion* of audit procedures when addressing identified risk factors; *inquiries* of audit committees and management; *evaluation* of the risk of management overriding controls; *deficiencies* of analytical procedures; *documentation* of performance of procedures and other deficiencies.

Petitioners and their amici use selected dictionary definitions of "strong" and "inference" to conflate the phrase "strong inference" with final "conclusions" about the merit

of the case regardless of its context in the pleading stage which frames the issue of the facts regarding the required state of mind. Webster's New 20th Century Dictionary, Unabridged Edition 1975, draws distinctions more apt to the question before the Court. It points out that "Conclusion signifies the final logical result in a process of reasoning. Deduction signifies the bringing or drawing of one thing from another. A conclusion is full and decisive. It ends all further reasoning. *An inference is partial and indecisive; a* conclusion ends all further reasoning." (*id.* at 938) Here the strong inference at the pleading stage is that there is a genuine issue for discovery and further proceedings, and that at this stage of the proceedings a reasonable jury could determine that CEO Notebaert acted with the required state of mind.

A few words will suffice with respect to the amici briefs by the Securities Industry, Joseph Grundfest and others which refer to the costs of "nuisance" filings and "abusive" litigation[4] and recommend diversification of investment as a substitute for actions by defrauded shareholders. In fact, securities class actions have been declining.[5]

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[4] *See, e.g.*, Brief for Amici Curiae Joseph Grundfest, et al pp. 4, 9. They quote Professor Coffee about the "routine filing" of "nonmeritorious" lawsuits (*id.* p.15), but do not note his statement that: "The true 'strike suit nuisance action,' filed only because it was too expensive to defend is, in this author's judgment, a beast like the unicorn, more discussed than directly observed." Coffee, REFORMING THE SECURITIES CLASS ACTION: AN ESSAY ON DETERRENCE AND ITS IMPLEMENTATION, 106 Col. Law. Rev 1534 (2006) at 1536 fn 5.

[5] In 2005, auditors were named in only five cases (3% of all securities class actions), Cornerstone Research study "Securities Class Action Case Filings 2005: A Year in Review" at 12. A later Cornerstone Research study "Securities Class Action Case Filings, 2006 MidYear Assessment" reports that filings "decreased noticeably in the first half of 2006" and that 2006 may reflect the lowest annual (Cont'd)

The Securities Industry's point of view is endorsed in a book by Professors Butler and Ribstein, THE SARBANES-OXLEY DEBACLE: WHAT WE'VE LEARNED: HOW TO FIX IT (American Enterprise Institute, 2006) which states, at p. 98, "Shareholders are better off diversified and rationally ignorant." That point of view cannot help but give rise to the impression that those who obtain their remuneration and fees as a result of market actions caused by fraud are indifferent to the damages suffered by shareholders. There is no reason why shareholders who are diversified should not also recover damages inflicted on them by fraud; nor why shareholders who are not diversified, sometimes because their pension plans do not permit it, should be left without remedies. Pleas by the major audit firms and the financial services industry to release them or limit their liabilities for fraud are not appropriately addressed to this Court. Investment markets are not a casino. Fraud destroys their integrity. The enforcement of laws against fraud is vital to society, including the financial sector.

(Cont'd)

filings since 1996. The lower filings in 2005 and 2006 were related, in part to corporate governance improvements since Sarbanes Oxley (*id.* at 2.)

Even more decisive in the real world is the report of the vice president of the Insurance Information Institute in New York that the costs of directors' and officers' liability insurance have plummeted in the past two years, falling almost 40% in 2005, an additional 10% in 2006, and would probably decline again in 2007. The vice president said that the "changes in corporate governance practices and transparency to shareholders as a result of the Sarbanes-Oxley Act have likely contributed to the decline in D&O rates," Gretchen Morgenson, FAIR GAME. MEMO TO SHAREHOLDERS: SHUT UP, *N.Y. Times*, February 11, 2007, at A1.

CONCLUSION

For the foregoing reasons, the judgment below should be affirmed and this Court should confirm the continued application to securities lawsuits of established Federal rules on burden of proof and terminal motions. Effective legal remedies are the only true deterrent to the abuse of corporate power.

Respectfully submitted,

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